DESCRIPTION OF H.R. 2792

RELATING TO

TAX TREATMENT OF INDIAN FISHING RIGHTS

Scheduled for a Public Hearing

Before the

Subcommittee on Select Revenue Measures

of the

COMMITTEE ON WAYS AND MEANS

on December 14, 1987

Prepared by the Staff

of the

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of H.R. 2792 (introduced by Messrs. Lowry, Matsui, Ford of Tenn., Russo, Chandler, and others). H.R. 2792 relates to the tax treatment of certain Indian fishing rights, and is scheduled for a public hearing on December 14, 1987, before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means. H.R. 2792 was jointly referred to the Committee on Ways and Means and the Committee on Interior and Insular Affairs. The Interior Committee favorably reported the bill on September 21, 1987 (H.Rpt. 100-312, Part 1).

The first part of the document is a summary. The second part is a description of H.R. 2792 and present law. The third part discusses issues relating to the bill.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of H.R. 2792: Relating to Tax Treatment of Indian Fishing Rights (JCX-24-87), December 11, 1987.

I. SUMMARY

In general, income, from whatever source derived, is subject to Federal income tax. Indians generally are subject to Federal tax like other U.S. citizens. Exemptions are provided in the Internal Revenue Code for certain types of income (e.g., gifts, bequests, and certain employee fringe benefits). Various treaties, Federal statutes, and executive orders have reserved to Indian tribes rights to fish, both on and off reservations. Most of these provisions were adopted before imposition of the Federal income tax. Under general tax principles, income derived from fishing activities is taxable, absent a specific Federal exemption.

H.R. 2792 would exempt from all Federal and State income ta.. ncome derived directly or indirectly by any Indian from the ercise of fishing rights reserved to Indians under Feder.. law.

II. DESCRIPTION OF H.R. 2792

Present Law

General tax principles

The Internal Revenue Code generally subjects to Federal income taxation "all income from whatever source derived" (Code sec. 61(a)). Certain items received by a taxpayer (e.g., gifts, bequests, and certain employee fringe benefits), however, are specifically exempted from Federal income taxation.[2] In the absence of a specific exclusion, taxable income generally includes any gain (meaning an accession to wealth), clearly realized, over which the taxpayer exercises dominion.[3] Such accessions to wealth may be derived from a wide variety of sources, including income from business activities, amounts paid to a taxpayer as salary, and economic gains resulting from a taxpayer's sale of property. Gross income for purposes of computing Federal income tax generally encompasses income realized in any form, whether in money, property, or services.[4] Under the general principles that govern the computation of taxable income, gains derived from commercial fishing activities ordinarily are subject to Federal income taxation.

Indian treaties and statutes

In ordinary matters not governed by treaties or remedial legislation, Indians are subject to the payment of Federal income taxes as are other citizens.[5] But in some situations, specific provisions in treaties or statutes have been construed to exclude from Federal taxation certain income derived from Indian lands held in trust by the United

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[2] See e.g., Code secs. 102 and 132.

[3] See Comm'r v. Glenshaw Glass Co., 348 U.S. 426 (1955).

[4] See Old Colony Trust Co. v. Comm'r, 279 U.S. 716 (1929).

[5] Indians and their property are exempt from State taxation within their reservations, unless Congress clearly manifests its consent to such taxation. See Montana v. Blackfeet Tribe of Indians, 471 U.S. 759 (1985); McClanahan v. Arizona State Tax Comm'n, 411 U.S. 164 (1973). In contrast, property and income earned outside the reservation have been held to be subject to State taxation, unless Federal law otherwise provides for an exemption. See Mescalero Apache Tribe v. Jones, 411 U.S. 145 (1973).

(Footnote continued)

States.[6] Income derived by Indians from individual or tribal-owned property has, in other situations, been held to be subject to Federal income tax.[7]

Questions have been raised whether a special tax rule should apply to income earned by members of certain Indian tribes from the exercise of fishing rights guaranteed by treaties, Federal statutes, and executive orders. The treaties at issue, most of which were entered into in the latter half of the 19th Century before adoption of the 16th Amendment pursuant to which the Federal income tax is imposed, generally secure to Indians who had relinquished all rights to large areas of land (mostly in the West and Great Lakes regions) the exclusive rights to fish on reservation property and the shared rights to fish off-reservation at "all usual and accustomed grounds and stations."[8]

The fishing rights reserved to Indians includes fishing for subsistence as well as for commercial purposes. In addition, certain hunting, gathering, and grazing activities are also secured to Indians by treaties, Federal statutes, and executive orders.[9]

The treaties, Federal statutes, and executive orders that reserve fishing rights to Indians do not contain provisions that specifically address the issue of Federal income taxation of Indian fishing activities, and the Supreme Court has not yet ruled on this particular question.[10] As a consequence, contrary positions have been adopted within the Federal Government on this issue. On the one hand, the

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[6](continued)
[6] See Squire v. Capoeman, 351 U.S. 1 (1956) (holding that gains from sale of timber on lands allotted to noncompetent Indians but held in trust by the United States pursuant to the General Allotment Act of 1887 was exempt from Federal income taxes).

[7] See Choteau v. Burnet, 283 U.S. 691 (1931) (income of competent Indian, who had unrestricted control over lands, held to be subject to tax); Superintendent of Five Civilized Tribes v. Comm'r, 295 U.S. 418 (1935) (income derived from reinvestment of surplus income from land held to be subject to tax). See also Fry v. Comm'r, 557 F.2d 646 (9th Cir. 1977) (taxing income from logging operation on reservation land); and United States v. Anderson, 625 F.2d 910 (9th Cir. 1980) (taxing income from cattle ranching on reservation land).

[8] See Washington v. Washington State Commercial Passenger Fishing Vessel Assoc., 443 U.S. 658, 662 (1979). Some of these treaties secure to Indian tribes the opportunity to
(Footnote continued)

Department of Interior has taken the position that treaty or statutory language that reserves fishing rights to Indians precludes Federal taxation of income derived from the exercise of those rights, because otherwise the tax, in essence, would be a charge imposed upon Indians for exercising their fishing rights that was not contemplated at the time the rights were reserved.[11] The Treasury Department, on the other hand, has attempted to collect income taxes on income earned by tribal fishermen from commercial fishing operations, on the ground that the fishing rights reserved to Indians do not encompass a right to be free from taxation on the profits from commercial fishing absent express exemptive language in the operative treaty or statute.[12]

Explanation of the Bill

H.R. 2792, as reported by the Committee on Interior and Insular Affairs, would provide that all income derived by an Indian from "the exercise of rights" to fish secured by any treaty, executive order, or Federal statute, is exempt from all Federal and State income tax (e.g., regular Federal income and Social Security taxes).[13] Fishing is defined to include not only actual harvesting of fish, but also the processing and preparation of fish for consumption.

The report of the Committee on Interior and Insular Affairs states that the term "exercise of rights" is to be construed broadly to apply both to income of individual Indians directly involved in fishing activities and also to the income of Indian-owned corporations, partnerships, or

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[8](continued)
catch up to 50 percent of the harvestable numbers of fish passing through their traditional fishing areas. Id. at 685.

[9] See Antoine v. Washington, 420 U.S. 194 (1975); Mattz v. Arnett, 412 U.S. 481 (1973).

Since 1871, when Congress prohibited further treaty making with Indian tribes, the usual method of dealing with Indian tribes and establishing reservations has been either by statute, executive order, or agreement later approved by an Act of Congress. See H. Rpt. 100-312, Part 1, at p. 2.

[10] In two cases, however, the Tax Court has held that income derived from the exercise of Indian fishing rights is subject to Federal income tax. Earl v. Comm'r, 78 T.C. 1014 (1982); Strom v. Comm'r, 6 T.C. 621 (1946), aff'd per curiam, 158 F. 2d 520 (9th Cir. 1947).

[11] See memorandum from Frank K. Richardson, Solicitor for
(Footnote continued)

other entities engaged in the fishing business, whether or not employees of the business are Indians. Additionally, the exemption applies to Indians deriving income from employment in a fishing business owned by another Indian.[14]

The bill further applies to income derived from both on-reservation and certain off-reservation fishing activities. Thus, the bill would provide an exemption to the general present-law rule that States may tax off-reservation income.

Effective Date

The provisions of the bill would be effective upon enactment, and would apply prospectively as well as retroactively to all periods for which the period of limitations for assessment of tax remains open.

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[11](continued)
the Department of Interior, to the Secretary of the Interior, dated March 12, 1985.

[12] See opinion of Office of Chief Counsel, Internal Revenue Service, dated November 23, 1983. However, in a letter to Senator Daniel J. Evans (D., Washington), dated May 12, 1987, the IRS stated that it will not pursue collection of tax on income from fishing rights pending consideration of legislation to exempt that income.

[13] Exemption from these taxes could have the corollary effect of making certain Indians ineligible for the earned income credit and for social security benefits. Additionally, the unemployment insurance taxes are based on covered wages. It is unclear whether exempt income from fishing rights would be wages subject to this tax. If the wages were not subject to tax, Indians receiving exempt income could be ineligible for unemployment compensation benefits.

[14] See H.Rpt. 100-312, Part 1, at pp. 6-7.

III. ISSUES RELATING TO THE TAX EXEMPTION OF INCOME FROM INDIAN FISHING RIGHTS

Tax Equity

Federal income tax law strives to attain horizontal and vertical equity in the distribution of the tax burden. The principle of vertical equity underlies the progressive income tax. This involves those with higher incomes paying a larger tax burden. The principle of horizontal equity is to treat people in like economic circumstances similarly.

Vertical equity

The benefit of tax-exemption for income from the exercise of fishing rights would be available to all Indians regardless of the level of their other income. Because income tax rates rise with income, the higher the income, the more benefit one can receive from tax-exemption. The very poor receive no benefit from the tax-exemption. Assume one could earn $3,000 from a tax-exempt activity. If one was heading a family of four whose other income totaled $7,000, the tax-exemption would have no additional benefit because the person would face no Federal income tax liability. However, if one was heading a family of four and had other income totaling $17,000, the tax-exemption on the additional $3,000 would be worth $450, because the Federal tax liability would be $450 on an additional $3,000 of income. Likewise, if the taxpayer were otherwise in the 28-percent bracket, the tax benefit of the tax-exemption would be $840.

Exempting the income earned by Indians from fishing would increase the disposable income of those Indians who currently pay Federal and State income taxes. However, the Tax Reform Act of 1986 has removed a substantial number of low-income Americans, including Indians, from the tax rolls. For example, in 1988 a family of four will face no Federal tax liability until the family's income exceeds $12,800. For families with less income, it does not matter whether the source of the income is tax-exempt or not.

While the very poor receive no direct benefit from a tax exemption for fishing income, they may benefit indirectly. Those who do receive a benefit from the exemption will have larger disposable incomes. Some people suggest that these funds may stay on the reservation rather than flowing to the Federal or State treasury, thereby fostering additional investment and creating more jobs for those who do not benefit directly.

The Lummi tribe of the State of Washington submitted a study to the Department of the Interior which suggests that

Indian fishing incomes vary widely.[15] The tribe had 583 members who sold fish during 1981 of whom 232 considered fishing to be their full-time occupation. The tribe's skiff fleet owners averaged a gross income of $6,000 per vessel in 1981, but the incomes ranged from a low of $600 to a high of $25,000. For the tribe's purse seine vessel owners, the average gross income was $172,000 per vessel with a low of $62,000 and a high of $347,000. Tribal fisherman who did not own boats averaged $5,600 in gross income.

Because American Indians as a class generally have lower incomes, many currently face no Federal income tax liability. They may face State income tax liabilities, however. Table 1 shows the percentage income distribution of American Indian, Eskimo and Aleut families compared to all U.S. families. If the percentage of American Indians living in poverty has remained relatively constant since 1980, Table 2 suggests that as many as 25 percent of all Indian families currently face no Federal income tax liability and that for families not living in SMSAs the figure exceeds 30 percent.

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15 See letter from Secretary of the Interior Hodel to Attorney General Meese, March 22, 1985.

Table 1.--Percentage Income Distribution of Families
(1979 income, percent of families)

Income	American Indian, Eskimo and Aleut families		All U.S. families
	All	non-SMSA	
0 - $5,000	16.0	19.7	7.3
$5,000-$7,499	10.4	11.9	6.2
$7.500-$9,999	10.0	11.4	6.9
$10,000-$14,999	17.6	18.5	14.7
$15,000-$19,999	14.5	14.2	15.1
$20,000-$24,999	11.3	9.6	14.3
$25,000-$34,999	12.5	9.5	19.1
$35,000-$49,999	5.6	3.6	10.7
$50,000+	2.3	1.6	5.6
TOTAL	100.0	100.0	100.0
Median Income (dollars)	$13,724	$11,686	$19,917
Mean Income (dollars)	$16,643	$14,462	$23,092

Source: U.S. Department of Commerce, Bureau of the Census, General Social and Economic Characteristics, 1980.

Table 2.--Percentage of Families with Incomes Below the Poverty Level, Indians and All U.S. Families, 1980

	American Indian, Eskimo and Aleut families		All U.S. families
	All	non-SMSA	
percent less than the poverty level[1]	23.7%	30.2%	11.1%

[1] The 1980 poverty level for a family of four was $8,414. The corresponding figure for 1987 is $11,637.

Source: U.S. Department of Commerce, Bureau of the Census, General Social and Economic Characteristics, 1980.

Horizontal equity

The tax-exemption proposed in H.R. 2792 would not be horizontally equal among Indians or among Indians as compared to non-Indians. For example, an Indian who earned $15,000 from exempt fishing activities would pay no tax on his earnings, while an Indian or a non-Indian who earned $15,000 from a factory job would pay tax on his earnings.

Respect of Indians' rights granted pursuant to treaties may outweigh such losses of horizontal equity.

Tax-Exemption and the Commercial Fishing Industry

At present, Indian fishermen are a small, but not insignificant, part of the commercial fishing market. Indians are more significant in some regions than in others. For instance, in the State of Washington, the value of the 1981 catch of the Lummi tribe (which accounts for 30 percent of all fishing licenses granted to Indians living on or near reservations in the State) was approximately $5.25 million. The 1981 value of the catch for the entire State was $96 million.[16] Nationwide, however, Indians account for only approximately one percent of the labor force which labels itself as fishermen.

H.R. 2792 would create a broad exemption from taxation. In addition to fishing, the bill would exempt fish processing plants if they were 100-percent Indian owned, regardless of whether Indians were employed in plant or not. The tax-exemption of H.R. 2792 might induce more Indians to try to earn their living from commercial fishing or processing rather than devote their talents elsewhere. This could produce a growth of Indian-owned and -managed fishing enterprises, thereby increasing employment and income opportunities for Indians.

The tax-exemption for income earned from fishing would give an Indian fisherman or processing plant a cost advantage over non-Indian fishermen or processing plants. Tax-exemption could help Indian fishing enterprises increase their market share by partially passing forward this cost advantage to consumers in the form of lower prices.

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16 See letter from Secretary of the Interior Hodel to Attorney General Meese, March 22, 1985; and U.S. Department of Commerce, Bureau of the Census, Statistical Abstract of the United States 1986.